

Kluwer Arbitration Blog

Countdown to RIDW25: Price Escalation Under Saudi Law

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The Kingdom of Saudi Arabia (“KSA”) is witnessing a significant surge in construction activity, from leading giga projects (such as NEOM and the Red Sea Project) to being selected as the host of the FIFA World Cup 2034 and Expo 2030. The KSA is now at the forefront of the region in this industry and is driving an unprecedented demand for materials, labour, and equipment.

Historically, inflation has not been a major issue for the KSA’s construction industry. However, recent global hyper-inflation and supply chain disruptions caused by geopolitical events have resulted in substantial cost overruns for many projects in the Middle East.

These unforeseen circumstances have placed contractors in a difficult position, as they now face the challenge of significantly higher costs to complete the same scope of work. Generally, engineering, procurement, and construction (“EPC”) contracts in the region are awarded on a lump sum basis, placing the inflation risk squarely on the contractor. Price adjustment clauses are usually excluded and material adverse change and hardship clauses are rare. This practice of risk allocation generally leaves contractors with limited options to manage escalating costs.

To mitigate financial strain, contractors have attempted to reinterpret force majeure events as changes in law and have explored other legal principles to support their claims, with varying degrees of success.

For many international contractors who have opted for English law as the governing law of their EPC contract, there is little relief. English law does not imply a duty of good faith or recognise force majeure at law. The doctrine of frustration, which can discharge parties from their contractual obligations when an unforeseen event fundamentally changes the nature of the contract, is also unlikely to assist where projects have become more expensive but are still possible to complete. This rigidity can leave contractors exposed to significant financial risk, jeopardising the entire project altogether.

In contrast, there may be some hope for parties who have agreed to have their EPC contracts governed by Saudi law. Historically, Saudi courts have been more likely to intervene based on the Shariah principle of fairness, which provides a potential lifeline to those facing significant cost escalations. This position has been maintained with the issuance of the Civil Transaction Law (“CTL”), which codified the courts’ powers to mitigate and rebalance unduly onerous terms. For instance, Article 95 of the CTL codified the duty of good faith, which may apply where there is an element of discretion involved on the employer’s part (such as when determining claims). Contractors may look to invoke this duty to argue for an equitable determination of the contractor’s

claims in light of unforeseen cost increases. However, depending on the circumstances, a duty to act in good faith will not generally require the employer to act to its own detriment.

Additionally, Article 97 of the CTL allows the court to adjust a burdensome obligation in exceptional unforeseen circumstances. This provision enables contractors to trigger a negotiation if exceptional circumstances of a general nature make a term of the contract particularly onerous, and ultimately opens the door for the court to reduce the burden of the obligation.

Article 471(3) of the CTL confers even broader powers on the court where the equilibrium between the parties has radically changed due to exceptional circumstances of a general nature: here the judge or arbitrator can restore the balance between the parties—including the contract price and the time for completion.

In conclusion, the Saudi legal system is continuously evolving to ensure that the KSA maintains a business-friendly environment in line with international best practices. By its codification of new and existing concepts relevant to construction contracts, the CTL represents a key step in the KSA's legal transformation. Given it is a relatively nascent law it remains to be seen how these provisions will be applied in practice.



We look forward to attending the SCCA 25 Conference!

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